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Retirement Policy

Proposed Retirement Plan Overhaul Faces Skepticism at Tax Reform Hearing

Employee benefits experts testifying before the Senate Finance Committee on Sept. 15 about tax reform options for retirement security largely called for retaining the current structure of retirement savings plans with some improvements, but one witness recommended an overhaul that would replace deductions with refundable tax credits.

Under the proposal outlined by William Gale, co-director of the Urban-Brookings Tax Policy Center, a flat-rate, refundable credit deposited directly into a retirement savings account would replace the present deduction for contributions to those accounts.

He was among three other witnesses who testified at the hearing, Tax Reform Options: Promoting Retirement Security.

The proposal, according to Gale's testimony, would:

- address long-standing concerns in the retirement saving system by improving incentives for most households to participate and by raising national saving;
- offset pressures created by the current weak economy for households to reduce their retirement saving; and
- help solve the long-term fiscal problem facing the country by raising $450 billion over the next decade in a manner that is consistent with the principles of broad-based tax reform and distributes the fiscal burden in a progressive manner.

''Stated simply, this proposal will make it viable for low- and middle-income households to increase their savings for retirement,'' said Gale, also a senior fellow with the Brookings Institution.

Ranking member Orrin Hatch (R-Utah), however, questioned the proposal in his opening statement at the hearing.

Hatch expressed skepticism ''that it is wise tax and retirement policy to experiment with our current defined contribution and IRA [individual retirement account] retirement saving system, a system benefiting many millions of Americans, by taking away pretax contributions and converting the system to a refundable tax credit program.''

System Needs Expansion, Not Overhaul. Judy Miller of the American Society of Pension Professionals and Actuaries said she saw little reason to change current tax incentives, which she said are achieving their goal of promoting retirement security.

''We need a tuneup, not an overhaul,'' Miller told the panel.

The key to enhancing the system already in place, she elaborated in her testimony, is ''expanding availability of workplace savings.''

''There is no need for dramatic changes, but measures should definitely be considered to make it easier for employers, particularly small businesses, to offer a workplace savings plan to their employees,'' she added.

A Joint Committee on Taxation report released in advance of the hearing summarized the current tax treatment of retirement savings arrangements (179 PBD, 9/15/11).

Meanwhile, Karen Friedman of the Pension Rights Center detailed a number of changes that could promote short-term savings within the framework of existing plans, including an expanded and refundable savers' credit, reverse match, incentives for defined benefit plans, and tax reform to limit leakage.

Friedman also called for a long-term, comprehensive overhaul that could lead to a new system that would build on Social Security, which she said needs to be retained and fortified.

The new system should hinge on universal coverage, secure retirement, and adequate income, she said.

Considering Consequences of Change. Jack VanDerhei, research director of the Employee Benefit Research Institute, sketched the impact that different kinds of tax reform approaches could have on retirement income adequacy.

''Given that the financial fate of future generations of retirees appears to be so strongly tied to whether they are eligible to participate in employer-sponsored retirement plans, the logic of modifying (either completely or marginally) the incentive structure of employees and/or employers for defined contribution plans at this time needs to be thoroughly examined,'' VanDerhei said in his testimony.

Defined contribution plans, and their subsequent IRA rollovers, ''are the component of retirement security that appears to be generating the most non-Social Security retirement wealth for baby boomers and Gen Xers,'' he said, citing EBRI studies.

''However, the potential increase of at-risk percentages resulting from (1) employer modifications to existing plans, and (2) a substantial portion of low-income households decreasing or eliminating future contributions to savings plans as a reaction to the exclusion of employee contributions for retirement savings plans from taxable income needs to be analyzed carefully when considering the overall impact of such proposals.''

By Christine Grimaldi

More information on the hearing is at http://finance.senate.gov/hearings/hearing/?id=ba387157-5056-a032-5252-c7bf71fc6c90.

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